19

FEB 21 1946
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 879

MAGNOLIA PETROLEUM COMPANY, *Petitioner*,

v.

W. A. THOMAS, *Collector of Internal Revenue*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

WALACE HAWKINS,
P. O. Box 900,
Dallas 1, Texas,

HOMER HENDRICKS,
Southern Building,
Washington 5, D. C.,

RAYMOND M. MYERS,
P. O. Box 900,
Dallas 1, Texas.
Counsel for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

Subject Index.

	Page
Petition for Writ of Certiorari	1-6
I. Short Statement of Matter Involved	1-4
II. Jurisdiction	4
III. Opinion Below	4
IV. Questions Presented	4-5
V. Reasons Relied on for Allowance of Writ	5-6
VI. Conclusion	6
Appendix—Statutes and Regulations Involved.	7-9
Brief in Support of Petition	10-27
I. Opinion Below	10
II. Jurisdiction	10
III. Statement of Case	11
IV. Specifications of Error	11
V. Argument	11-26
VI. Conclusion	26-27

Authorities.

Aluminum Company of America v. United States, 67 Fed. (2d) 172, cert. den., 291 U. S. 666	23, 25
Anglo-California Bank v. Secretary of the Treasury, 76 Fed. 742	13
Brownsville Coal & Coke Company v. Heiner, 38 Fed. (2d) 248	25
Burnet v. Sanford & Brooks Co., 282 U. S. 359	21
Burnet v. Aluminum Goods Company, 287 U. S. 544	17
Campbell v. United States, 107 U. S. 407	13
Cereal Products Refining Corporation, 39 B. T. A. 92	14
Crews v. Commissioner, 89 Fed. (2d) 412	20

Page

Darby-Lynde v. Commissioner, 51 Fed. (2d) 32..... 18
Helvering v. Morgan's, Inc., 293 U. S. 121..... 21
Hoffer Oil Corporation v. Commissioner, 27 B. T. A. 98 18
Lucas v. Structural Steel Company, 281 U. S. 264.... 22
Manhattan Co. v. Commissioner, 297 U. S. 129..... 14
Merritt v. Welsh, 104 U. S 694..... 13
Miller v. United States, 294 U. S. 435.....13-14
Packard Motor Car Company v. United States, 39 Fed. (2d) 991 (cert. den., 51 S. Ct. 27)..... 25
Planters' Cotton Oil Co., Inc. v. Hopkins, 286 U. S. 332 19
Regulations of Commissioner of Internal Revenue:
Article 22(c)-2 of Regulations 86..... 8-9
Article 113(a)(11)-1 of Regulations 86..... 8
Section 23.39, subsection (b)(2) of Regulations 104 23-24
Section 23.39, subsection (b)(3) of Regulations 104.24-25
Revenue Act of 1934:
Section 22(c) 7, 14
Section 113(a)(1) 7, 17
Section 113(a)(11) 7
Rialto Mining Corporation, 25 B. T. A. 980..... 18
Swift & Co. v. United States, 69 Ct. Cls. 171..... 17
Tulsa Tribune Company v. Commissioner of Internal Revenue, 58 Fed. (2d) 937..... 12
United States v. Foster, 211 Fed. 206..... 13
United States v. 200 Barrels of Whiskey, 95 U. S. 571.. 13
Weber Flour Mills Co. v. Commissioner, 82 Fed. (2d) 764 18-19
Woolford Realty Co., Inc. v. Rose, 286 U. S. 319.....19-20

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No.

MAGNOLIA PETROLEUM COMPANY, *Petitioner,*

v.

W. A. THOMAS, *Collector of Internal Revenue.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Your petitioner, MAGNOLIA PETROLEUM COMPANY, a Texas corporation, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit, entered December 4, 1945 (R. 35) in a suit there entitled "Magnolia Petroleum Company, a corporation, appellant v. W. A. Thomas, Collector of Internal Revenue, appellee," affirming a judgment of the District Court of the United States for the Northern District of Texas (R. 24-25).

I. SHORT STATEMENT OF THE MATTER INVOLVED.

Magnolia Petroleum Company, a Texas corporation, petitioner, is engaged in the business of producing, refining and marketing crude oil and the products thereof in Texas and other States.

Magnolia Pipe Line Company transports most of petitioner's oil and collects therefor under published tariffs duly filed with the Interstate Commerce Commission and with the proper authorities in the various States concerned. The profit which is realized by Magnolia Pipe Line Company is included in its income and also figures in the valuation of the inventories of the petitioner in so far as it relates to products which have been transported and which remain on hand at the end of the respective taxable periods for which separate returns are filed.

For the year 1933 petitioner, under the provisions of law then in force and as part of an affiliated tax-computing group consisting of Socony-Vacuum Oil Company, Incorporated, Magnolia Pipe Line Company, Vacuum Oil Company, Inc., and others, filed a consolidated income tax return. In this consolidated return the closing inventory of the group did not include transportation costs paid Magnolia Pipe Line Company by petitioner, except to the extent of cost of said transportation to Magnolia Pipe Line Company. The inventory products acquired from Vacuum Oil Company, Inc., were valued at cost to Vacuum not to petitioner. The said consolidated return showed net income of $5,434,888.40, with a resultant income tax of $788,058.82 against which there was claimed credit for foreign taxes paid of $1,800,897.88; there was subsequently filed with the examining agent of the Bureau of Internal Revenue tax receipts and other data supporting foreign tax credit in the amount of $1,725,266.05.

The Revenue Act of 1934 withdrew the privilege of filing consolidated returns and therefore petitioner, for the year 1934, filed its separate return. In this return petitioner set out its opening inventory at a value of $33,637,338.00 and its closing inventory at a value of $39,818,381.13. In valuing the opening and closing inventories for the year 1934 petitioner included the cost to it of transporting the oil and other products included in the inventory, that is, it included in the value of such inventory the amount paid

Magnolia Pipe Line Company for transporting said products.

Likewise, in said inventories, products acquired from an affiliated company, Vacuum Oil Company, Inc., were valued at the cost of these products to petitioner rather than to Vacuum Oil Company, Inc.

In petitioner's separate income tax return for the calendar year 1935 petitioner fixed the value of its opening inventory at $39,818,381.13 and of its closing inventory at $36,643,528.79. In computing the value of its opening and closing inventory for the year 1935, petitioner followed the same procedure at it did for the year 1934 as above set out..

The Internal Revenue Agent reduced petitioner's opening inventory as of January 1, 1934, to the same figure as the closing inventory reported upon the affiliated basis for the calendar year of 1933, thereby decreasing petitioner's opening inventory for 1934 by the sum of $2,536,328.31. Included in this figure is the amount of $2,493,872.31 which is the difference between the amount paid by petitioner to the pipe line company at tariff rates and the cost to the pipe line company of transporting said oil. The balance represents the difference between the cost of goods to petitioner and cost to Vacuum Oil Company, Inc., affecting goods purchased by petitioner from Vacuum Oil Company, Inc. The Agent also decreased the closing inventory as of December 31, 1934, by $344,314.48 to bring the cost of products remaining at that time out of the December 31, 1933, inventory to the same affiliated cost basis. These changes resulted in a total addition of $2,192,013.83 to income for the year 1934. Likewise, the Revenue Agent adjusted the opening inventory for 1935 to the same figure as fixed by him as the closing inventory for 1934, thereby increasing the income for the year 1935 by the sum of $344,314.48. This resulted in the assessment of additional taxes and interest in the sum of $444,180.19, which amount was paid by petitioner (R. 13-16).

The Commissioner did not value the opening inventory for 1934 on the same basis as he used in valuing the closing inventory for that year. This was due to the fact that the opening inventory for 1934 was valued at cost to the affiliated group, of which petitioner was a member, whereas the closing inventory, except for the products remaining out of the opening inventory, was valued on the basis of cost to the petitioner (R. 16). It is agreed that if petitioner was correct in its handling of inventories it should recover the amount sued for and that if the Commissioner was correct, the Collector of Internal Revenue should prevail (R. 18).

II. JURISDICTION.

This court has jurisdiction to review the decision of the United States Circuit Court of Appeals for the Fifth Circuit under the authority of the Act of February 13, 1925; C. 229; 43 Stat. 936, as amended (Section 240 of the Judicial Code, Title 28, Section 347, U. S. C. A.).

The Circuit Court has decided an important question of federal law which has not been but should be settled by this court.

III. OPINION BELOW.

The opinion (R. 31) of the Circuit Court of Appeals is reported in 151 F. (2d) 1008.

IV. QUESTIONS PRESENTED.

What is the proper value of the opening and closing inventories of taxpayer for the years 1934 and 1935?

Petitioner placed crude oil in its inventories for said years at cost to it, including the cost of transportation of said oil by a pipe line at tariff rates actually paid. The Commissioner deducted from the cost of said oil in petitioner's inventories the difference between the amount paid by petitioner to the pipe line company and the cost to the

pipe line company of transporting said oil. The Commissioner accomplished this by using as petitioner's opening inventory in its separate return for 1934 the same value as was used in the closing inventory of 1933, a year in which a consolidated return was filed and in which intercompany profits had been eliminated. The sole question here is whether the Court erred in sustaining the action of the Commissioner in thus deducting from the cost of oil in petitioner's inventories a part of the cost of transporting it. The same question is involved in determining whether the Court erred in sustaining the action of the Commissioner in valuing the products purchased during affiliation by petitioner from Vacuum Oil Company at cost to Vacuum Oil Company rather than at cost to petitioner.

STATUTES AND REGULATIONS INVOLVED.

Applicable statutes and regulations are printed in the Appendix. *Infra*, pp. 7-9.

V. REASONS RELIED ON FOR ALLOWANCE OF WRIT.

The reasons relied on, as more fully presented in the accompanying brief, are:

(1) The Circuit Court has decided an important question of federal law which this Court has not passed on.

(2) This Court should pass on the question for the reason that the Circuit Court has erroneously decided the same, and this Court should review that decision and correctly settle the matter.

(3) Article 113(a)(11)-1 of Regulations 86, claimed to be controlling in this case, has no legal basis in the Revenue Act of 1934 and is void.

(4) The Commissioner has acted arbitrarily and without authority in this case.

(5) The evidence is undisputed that the regulations relied upon by the Commissioner in valuing inventories do

not conform to the best accounting practice in the business of taxpayer and do not most clearly reflect its income.

VI. CONCLUSION.

WHEREFORE, MAGNOLIA PETROLEUM COMPANY, petitioner, through its undersigned attorneys, prays that a writ of certiorari issue directed to the United States Circuit Court of Appeals for the Fifth Circuit, to review the judgment entered on the 4th day of December, 1945 (R. 35) in a suit there entitled "Magnolia Petroleum Company vs. W. A. Thomas, Collector of Internal Revenue," and that upon hearing said judgment be reversed and set aside.

Respectfully submitted,

WALACE HAWKINS,
P. O. Box 900,
Dallas 1, Texas,

HOMER HENDRICKS,
Southern Building,
Washington 5, D. C.

RAYMOND M. MYERS,
P. O. Box 900,
Dallas 1, Texas,
Counsel for Petitioner.